Internal Revenue Service

memorandum

CC:TL-N-7502-88
Br4:JTChalhoub

date: SEP 06 1988

to: District Counsel, Manhattan CC:MAN

from: Director, Tax Litigation Division CC:TL

subject: [redacted] and [redacted] -- Request for Technical Advice

This is in response to your request for technical advice with respect to proposed deficiencies and penalties applicable to the above corporations, both of which were qualified as regulated investment companies (RIC's) under Subchapter M of Chapter 1 of the Code.

ISSUES

1. Where an agreement has been reached with the district director to allow deficiency dividends to be paid and deducted by the RIC under I.R.C. § 860 to prevent loss of status as a RIC in a situation where the corporate income tax return was filed late, does the Service have authority to issue a notice of deficiency to the RIC with respect to the disputed delinquency penalty under I.R.C. § 6651(a)(1) if the RIC has waived and paid all of the tax, interest and other penalties due from such late filing?

2. Under the facts presented in Issue 1, does the fact of remittance to the IRS of the disputed delinquency penalty affect the authority to issue a notice of deficiency which would allow the RIC to contest in the Tax Court lack of reasonable cause for imposition of the penalty?

CONCLUSIONS

1. Under Rev. Rul. 78-20, 1978-1 C.B. 441 and G.C.M. 37172, issued June 21, 1977, Service position is as stated in the court reviewed opinion of Estate of DiRezza v. Commissioner, 78 T.C. 19 (1982). Thus, even though each RIC corporation has waived the deficiency pursuant to I.R.C. § 6213(d) with respect to an increase in income tax, a notice of deficiency may be issued to permit the RIC to challenge the Service's authority to impose the delinquency penalty on the ground that reasonable cause existed for such delinquency.

2. Your request for technical advice states that [redacted] paid the proposed I.R.C. § 6651(a)(1) penalty without signing a waiver. Informally, you

later advised that [redacted] also remitted the exact amount of the proposed delinquency penalty without signing a waiver. We assume both payments were made without instructions to treat the remittance as a deposit in the nature of a cash bond.

Under Rev. Proc. 84-58, 1984-2 C.B. 501, the authority to send a notice of deficiency (referred to in conclusion 1 above) has been rendered moot by acceptance of the remittance. Since the taxpayer corporations did not specifically designate treatment as a deposit, paragraph 1 of section 4.03 states Service position that the remittance will be treated as a payment of the delinquency penalty and will be assessed. Payment of the penalty will require the taxpayer to file a claim for refund of the penalty, the denial of which will force the taxpayer to file suit in a district court or the United States Claims Court to contest reasonable cause for filing the return late. Under I.R.C. §§ 6662 and 6211 there is, statutorily, no longer a deficiency with respect to the delinquency addition to tax. A notice of deficiency should not be issued to the corporations and they may no longer elect to contest the penalty in the Tax Court as a deficiency.

FACTS

We will keep recitation of the facts to a minimum. Suffice it to say the corporate income tax return, Form 1120, of each corporation was filed two months late and both corporations claim they inadvertently failed to follow their usual and customary procedure of requesting an automatic extension of time to file. Because the failure to file results in a forfeiture of status as an RIC, the Code provides a means of recovering that status by paying deficiency dividends under I.R.C. § 860.

Maintaining status as a RIC allows a corporation to pass through all income and expenses to the shareholders and to not be liable for Federal income tax. After an examination of the returns the Service proposed that the corporations would be permitted to deduct their deficiency dividends under I.R.C. § 860, but they would be liable for interest on the deficiency dividend deduction, for a penalty under I.R.C. § 6697 and for the delinquency penalty. The corporations signed an I.R.C. § 6213(d) waiver for the interest and for the I.R.C. § 6697 penalty. However, the corporations both maintained that a delinquency penalty under I.R.C. § 6651 should not be asserted because there was reasonable cause, in their view, for late filing. The corporations then paid the interest and § 6697 penalty agreed to. At a later date each corporation remitted to the Service the proposed delinquency penalty, $[redacted] from [redacted] and $[redacted] from [redacted].

DISCUSSION

In these cases, the [redacted] return was due on [redacted]. The return, as filed on [redacted], without an appropriate extension, showed no taxable income because the correct dividend deduction was claimed thereon. However, the amount of dividend paid deduction included an amount which had not yet been paid, so a deficiency dividend procedure was implemented under I.R.C. § 860. Pursuant to Treas. Reg. § 1.860-3(a), the amount of deficiency dividend that was unpaid is considered a deemed increase in tax for purposes of computing interest and additions to the tax including the delinquency penalty.

The issue of reasonable cause for non-applicability of the delinquency penalty is an issue of fact. The Appeals Conferee is convinced that notices of deficiency should be issued to each RIC for the amount of the delinquency penalty. In an ordinary situation involving a late filed income tax return, the Service determined a deficiency in income tax, which was waived under I.R.C. § 6213(d), but the taxpayer protested and did not waive the delinquency penalty. The Tax Court, in a reviewed opinion, concluded that the unagreed delinquency penalty was, nonetheless, "attributable to" a deficiency. Consequently, the Tax Court had jurisdiction. See Estate of DiRezza v. Commissioner, 78 T.C. 19 (1982).

Moreover, Rev. Rul. 78-20, 1978-1 C.B. 441 concludes as follows:

> The increase in the section 6651(a)(1) of the Code addition to the tax is attributable to the adjustments to the income tax liability. The increased income tax liability resulting from such adjustments is a "deficiency" within the meaning of section 6211(a). Therefore, the increase in the section 6651(a)(1) addition to the tax is attributable to a deficiency for purposes of section 6659(b) [now § 6662(b)]. Since the taxpayer has not waived the section 6213 restrictions on assessment and collection with respect to the increase in the section 6651(a)(1) addition to the tax, such restrictions apply.

Although Judge Nims dissent in DiRezza, 78 T.C. at 41 concludes that Rev. Rul. 78-20 is contrary to the view expressed in the Court's majority opinion, we fail to see any contrary view therein. Accordingly, the Service position is that waiver of a deficiency in tax does not prevent issuance of a notice of deficiency for an addition to the tax that is "attributable to" the deficiency that was waived.

However, the question here is further complicated by the "payment" of the disputed addition to the tax. Once a remittance has been received that relates to a disputed addition to tax, Rev. Proc. 84-58, 1984-2 C.B. 501 provides rules for treatment of the remittance as either a payment of tax or as a deposit. The issue now is whether the addition to tax itself can be classified as a deficiency, within the meaning of I.R.C. §§ 6662 and 6211, if it is paid prior to issuance of a notice of deficiency.

Treas. Reg. § 301.6213-1(b) provides in relevant part, as follows:

> If any payment is made before the mailing of a notice of deficiency, the district director or the director of the regional service center is not prohibited by section 6213(a) from assessing such amount, and such amount may be assessed if such action is deemed to be proper. If such amount is assessed, the assessment is taken into account in determining whether or not there is a deficiency for which a notice of deficiency must be issued. Thus, if such a payment satisfies the taxpayer's tax liability, no notice of deficiency will be mailed and the Tax Court will have no jurisdiction over the matter. [Emphasis supplied.]

The above-cited regulation provides discretion in the Service with respect to treatment of "payments" made, or remittances received, as taxes, including additions to the tax treated in the same manner as taxes pursuant to I.R.C. § 6662. Rev. Proc. 84-58, 1984-2 C.B. 501 provides specific instructions on treatment of such remittances and reflects the Service's position and application of the regulation.

Section 4.02, paragraph 1, of Rev. Proc. 84-58 states, in relevant part, as follows:

> A remittance made before the mailing of a notice of deficiency that is designated by the taxpayer in writing as a deposit in the nature of a cash bond will be treated as such by the Service.

Paragraph 3 of section 4.02 provides, in relevant part, as follows:

> Upon completion of an examination, if a taxpayer who has made a deposit does not execute a waiver of restrictions on

> assessment and collection or otherwise agree to the full amount of the deficiency, the Service will mail a notice of deficiency and the taxpayer will have the right to petition the Tax Court. That part of the deposit that is not greater than the deficiency proposed plus any interest that has accrued on the deficiency will be posted to the taxpayer's account as a payment of tax at the expiration of the 90 or 150-day period unless the taxpayer rerequests in writing before the date that the deposit continue to be treated as a deposit after the mailing of the notice of deficiency.

Paragraph 1 of section 4.03 provides, in relevant part, as follows:

> A remittance not specifically designated as a deposit in the nature of a cash bond will be treated as a payment of tax [here the § 6651(a)(1) delinquency penalty] if it is made in response to the proposed liability, for example, as proposed in a revenue agent's or examiner's report, and remittance in full of the proposed liability is made. [Emphasis supplied.]

Section 3.05 provides as follows:

> Paragraph 1 of section 4.03 and paragraph 3 of section 4.02 provide that payments will normally be "posted" rather than "assessed." Assessments of payments as tax are made discretionary to the Internal Revenue Service by the Code. Posting payments of tax liabilities ultimately determined to be due assures proper credit and has no adverse effect upon taxpayers with respect to the running of interest.

You have indicated that the [redacted], while not agreeing to assessment of the delinquency penalty proposed by the examiner, made a payment of the proposed penalty on [redacted]. A similar payment was also made, more recently, by [redacted]. You believe that payment of an amount designated as a tax (in this case the delinquency penalty treated as a tax pursuant to I.R.C. § 6662), requires the Service to assess that payment as a tax and, consequently, bars the Service from issuing a notice of deficiency with respect to the delinquency penalty. You cite I.R.C. § 6213(b)(4) as authority for your position. We agree,

generally, with your analysis, except that I.R.C. § 6213(b)(4) is couched in terms of the permissive (may) rather than the mandatory (shall) be assessed and Rev. Proc. 84-58 provides the Service position on when an assessment will be made rather than a mere posting of a remittance to the account of the taxpayer. Once a payment of tax has been made, the definition of deficiency provides specific rules on how a deficiency can be determined. I.R.C. § 6211 includes prior assessments and collections of tax without assessment as a reduction from the amount determined as a deficiency.

Since you did not include any facts in your request for technical advice concerning specific instructions by the taxpayer corporations to the Service that remittances should be treated as a deposit in the nature of a cash bond, we will assume no such instruction was made at the time of payment. The question of intention to make a deposit is a question of fact based upon the facts and circumstances surrounding the remittance at the time the remittance was made. See, e.g., Lewyt Corp. v. Commissioner, 215 F.2d 518 (2d Cir. 1954), aff'd on other grounds, 349 U.S. 237 (1955); Ameel v. United States, 426 F.2d 1270 (6th Cir. 1970).

Accordingly, paragraph 1 of section 4.03 of Rev. Proc. 84-58 applies and we conclude, as you do, that assessment should be made of the payments of additions to tax proposed by the examiner against both corporations. Consequently, no notice of deficiency may be issued to either RIC and such corporations will be required to file claims for refund and litigate the reasonable cause issue in a refund suit. If you have any further questions please contact Joseph T.Chalhoub at FTS 566-3345. We herewith return the partial administrative file you transmitted with your request for technical advice.

MARLENE GROSS
Director

By: _____
HENRY G. SALAMY
Chief, Branch No. 4
Tax Litigation Division

Attachment:
Partial Admin. File